

Message Text

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ACTION NEA-10

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R 261233Z AUG 76

FM AMEMBASSY NEW DELHI

TO SECSTATE WASHDC 7958

INFO AMCONSUL BOMBAY

AMCONSUL CALCUTTA

AMCONSUL MADRAS

UNCLAS NEW DELHI 12568

PASS TREASURY AND FRB

E.O. 11652: N/A

TAGS: EFIN IN

SUBJECT: RBI MOVES TO FURTHER RESTRAIN CREDIT EXPANSION AND
CURB INFLATION

SUMMARY. THE RESERVE BANK OF INDIA (RBI) HAS ANNOUNCED THAT CASH RESERVES REQUIRED TO BE MAINTAINED BY ALL SCHEDULED COMMERCIAL BANKS WILL BE RAISED FROM 4 PERCENT TO 5 PERCENT OF TOTAL BANK DEMAND AND TIME LIABILITIES. THIS MOVE, TAKEN TO SIPHON EXCESS LIQUIDITY IN THE MONEY MARKET, WILL BECOME EFFECTIVE SEPTEMBER 4, 1976.
END SUMMARY.

1. THE RESERVE BANK OF INDIA (RBI) HAS DECIDED TO RAISE CASH RESERVE RATIO OF SCHEDULED COMMERCIAL BANKS FROM 4 PERCENT TO 5 PERCENT IN ORDER TO MOP UP EXCESS LIQUIDITY IN THE BANKING SYSTEM. WITH THIS MOVE, THE STATUTORY LIQUIDITY RATIO WILL BE RAISED FROM 37 PERCENT TO 38 PERCENT. THE NEW CASH RESERVES RATIO, WHICH COMES INTO EFFECT FROM THE WEEK BEGINNING SEPTEMBER 5, IS EVIDENCE THAT THE RBI WANTS THE COMMERCIAL BANKS TO GO SLOW ON CREDIT EXPANSION.

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BANKS WILL BE PAID INTEREST ON THE

ADDITIONAL RESERVES BEING HELD AT A RATE OF 5.5 PERCENT A YEAR.

2. RBI GOVERNOR PURI, IN A LETTER TO ALL COMMERCIAL BANKS, HAS POINTED OUT THAT SINCE MAY 10, WHEN HE MET THE CHIEF EXECUTIVES OF THE MAJOR BANKS, FURTHER PRESSURES HAD DEVELOPED IN REGARD TO THE MONETARY AND PRICE SITUATION WHICH WAS AGGRAVATED BY SOME SPECULATIVE TENDENCIES IN THE SENSITIVE COMMODITY MARKETS.

3. IN THE PERIOD FROM APRIL 1 TO AUGUST 13, 1976, THE MONEY SUPPLY WITH THE PUBLIC HAS RISEN BY 7.7 PERCENT COMPARED WITH AN INCREASE OF 4.6 PERCENT IN THE SAME PERIOD LAST YEAR. BANK CREDIT HAS EXPANDED BY RS. 8,640 MILLION (DOLS972 MILLION) AGAINST A DECLINE OF RS. 340 MILLION (DOLS38 MILLION) IN THE CORRESPONDING PERIOD OF 1975-76. WHILE THE GREATER PART OF THE CREDIT EXPANSION THIS FISCAL YEAR COULD BE ATTRIBUTED TO FOOD PROCUREMENT, NON-FOOD CREDIT HAS ALSO SHOWN A SUBSTANTIAL RISE OF RS. 2,050 MILLION (DOLS230 MILLION) AGAINST A NET DECLINE OF RS. 850 MILLION (DOLS96 MILLION) IN THE SAME PERIOD OF THE PRECEDING YEAR.

4. THE GOVERNOR ALSO POINTED OUT THAT THERE IS CONSIDERABLE LIQUIDITY IN THE MONEY MARKET, BROUGHT ABOUT AMONG OTHER REASONS BY "FAST ACCRETIONS OF DEPOSIT RESOURCES" OF COMMERCIAL BANKS WHICH HAVE GROWN BY 10.9 PERCENT AGAINST 8.3 PERCENT LAST YEAR. THE EXCESS LIQUIDITY WITH THE BANKING SYSTEM IS REFLECTED BY THE FACT THAT WHILE THE COMMERCIAL BANKS ARE ENTITLED TO BORROW RS. 9,200 MILLION FROM THE RBI FOR REFINANCING FOOD PROCUREMENT CREDIT, THEY HAVE ACTUALLY BORROWED ONLY RS. 7,200 AS OF AUGUST 13.

5. SEPTEMBER 11 HAS BEEN PROPOSED BY GOVERNOR PURI FOR THE NEXT ROUND OF DISCUSSIONS WITH THE CHIEF EXECUTIVES OF THE MAJOR BANKS. AT THAT TIME HE WILL DISCUSS THE FOLLOWUP ACTION NECESSARY TO CONTAIN CREDIT EXPANSION AT THE DESIRED LEVEL IN THE INTEREST OF THE ECONOMY.SAXBE

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